

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
GEORGE ANAGNOSTAKOS	:	DETERMINATION
D/B/A PEGASUS RESTAURANT	:	
for Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period June 1, 1982	:	
through August 31, 1985.	:	

Petitioner, George Anagnostakos d/b/a Pegasus Restaurant, 222 Lyell Avenue, Rochester, New York 14060, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1982 through August 31, 1985 (File No. 802947).

A hearing was held before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 259 Monroe Avenue, Rochester, New York, on May 17, 1988 at 9:15 A.M., with all briefs to be filed by June 24, 1988. Petitioner appeared by Pheterson and Pheterson (Irving Pheterson, Esq., of counsel). The Audit Division appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

ISSUES

I. Whether petitioner established that the amount of sales tax assessed was erroneous or that the method of audit was unreasonable.

II. Whether petitioner has shown that his failure to accurately report and pay over sales taxes was due to reasonable cause and was not due to willful neglect.

FINDINGS OF FACT

1. On December 19, 1985, the Division of Taxation ("Division") issued to Pegasus Restaurant two notices of determination and demands for payment of sales and use taxes due. The first notice was for the period June 1, 1982 through November 30, 1984 and assessed sales tax of \$6,403.81 plus penalty and interest. The second notice was for the period December 1, 1984 through August 31, 1985 and assessed tax of \$907.41 plus penalty and interest. Pegasus Restaurant was owned and operated as a sole proprietorship by petitioner, George Anagnostakos.

2. The assessments resulted from an audit of Pegasus Restaurant.

(a) A routine computer match disclosed that in 1983 there was a difference of \$52,543.00 between gross receipts as reported on petitioner's Federal Schedule C and taxable sales as shown on his State sales tax returns.

(b) On October 11, 1985, two auditors met with petitioner and his accountant, Carl Nanni, to discuss the apparent discrepancy in the Federal and State returns. The auditor's contact sheet

states that Mr. Nanni provided the auditors with Federal Schedule C's for the years 1982 and 1984; copies of those returns were in the Division's files. Mr. Nanni and petitioner claimed that the differences in the 1983 Federal and State figures were attributable to personal consumption of food by petitioner and employees, gift certificates for free meals and a two-for-one discount program called "Dine-A-Mate".

(c) Petitioner's books and records were inadequate for audit purposes. Cash register tapes were not available, guest checks were disorganized and undated, the sales journal lacked entries for the period January 1, 1983 through August 31, 1983 and many entries were illegible. Petitioner's accountant failed to provide exempt organization certificates or other records to substantiate claimed nontaxable sales.

(d) The auditors estimated tax due for the audit period using a rate of difference calculated on the basis of the 1983 calendar year tax returns. Gross receipts reported on petitioner's 1983 Federal Schedule C were \$201,719.00. After adjusting quarterly sales tax periods to correspond to the calendar year, the auditors determined that petitioner reported taxable sales in 1983 of \$149,176.00. The difference of \$52,543.00 was divided by reported taxable sales to calculate a 35.22 percent rate of difference between gross receipts per Federal returns and taxable sales per State sales tax returns.

(e) The 35.22 percent rate of difference was applied to reported taxable sales for each quarter in the audit period to compute additional taxable sales of \$104,446.00 with a tax due on that amount of \$7,311.22.

3. Mr. Anagnostakos began operating Pegasus Restaurant in March 1982. Mr. Nanni was his accountant from the business's inception. Mr. Anagnostakos separately recorded his food and liquor sales on daily sheets. The daily sheets were given to Mr. Nanni each month to use in preparing sales and income tax returns. Mr. Anagnostakos retained the restaurant's cash register tapes and guest checks. This system of recordkeeping was devised by Mr. Nanni.

4. Mr. Anagnostakos participated in the Dine-A-Mate program. Dine-A-Mate customers were allowed to purchase two meals for the price of one. At Mr. Nanni's instruction, the full price of both meals was recorded on the guest checks and restaurant tapes. The free meals were recorded in a separate book. Mr. Nanni was to subtract the free meals from gross receipts when preparing petitioner's tax returns.

5. When the audit began, Mr. Anagnostakos gave Mr. Nanni all of his cash register tapes, guest checks, a copy of the Dine-A-Mate record book and other records in his possession in order to enable Mr. Nanni to present his case to the auditors. In January 1986, Mr. Anagnostakos gave Mr. Nanni \$750.00 to obtain an attorney to challenge the assessment. Mr. Nanni repeatedly assured Mr. Anagnostakos that his protest of the assessment was proceeding as expected.

6. Because he believed that Mr. Nanni was not properly representing him, Mr. Anagnostakos retained a lawyer, Irving Pheterson, in the spring of 1987. Upon the recommendation of his attorney, Mr. Anagnostakos hired a new accountant, Christopher Sardone, in May 1987.

7. Both Mr. Pheterson and Mr. Sardone attempted to recover Mr. Anagnostakos's records from Mr. Nanni without success. Mr. Sardone visited Mr. Nanni's office where he was ushered into a room filled with boxes of records in no particular order and told that Mr. Anagnostakos's records were somewhere among them. Mr. Nanni promised to forward the records to Mr.

Sardone when they were found. This never occurred.

8. Pegasus Restaurant was closed for remodeling in August 1987. At Mr. Sardone's suggestion, a corporation was formed to operate the restaurant when it reopened. Mr. Sardone established a new accounting system for the restaurant and arranged for Mr. Anagnostakos to employ a new payroll service. Mr. Anagnostakos's prior service was operated by Mr. Nanni.

9. Mr. Anagnostakos speaks English as a second language. Because he was not knowledgeable in the areas of taxation or bookkeeping, he relied entirely on Mr. Nanni to establish a recordkeeping system, to inform him of his obligations under the Tax Law and to prepare his tax returns.

10. Although Mr. Anagnostakos's Federal Schedule C shows that he actively operated Pegasus Restaurant for 10 months in 1982, he did not begin filing sales tax returns until the period ended August 31, 1982. The Federal Schedule C shows gross receipts in the 1982 calendar year of \$154,208.64 or average monthly sales of \$15,420.86. Sales tax returns filed for the period June 1, 1982 through November 30, 1982 show reported taxable sales of \$86,561.00 or average monthly taxable sales of \$14,426.83. The rate of difference between gross receipts and taxable sales in this period is 6.89 percent.

11. Mr. Anagnostakos's 1984 Federal Schedule C shows gross receipts of \$214,550.79. In the period January 1, 1984 through December 31, 1984, Pegasus Restaurant reported taxable sales of \$206,097.00. The rate of difference for this period is 4.1 percent.

12. For the period January 1, 1985 through August 31, 1985, the auditor determined that the restaurant's sales journal showed total taxable sales of \$131,717.00. After making adjustment to correlate quarterly returns with calendar months, the auditor determined that petitioner reported taxable sales of \$118,755.00 for the same period. The rate of difference between the sales as shown in the sales journal and sales as reported is 10.91 percent.

SUMMARY OF THE PARTIES' POSITIONS

13. Petitioner contends that the Division should have taken into account gross receipts reported on his 1982 and 1984 Federal Schedule C, rather than relying entirely on the 1983 returns. Petitioner's accountant recalculated petitioner's tax liability on the basis of tax returns filed in 1982, 1983 and 1984. He aggregated gross receipts reported on Schedule C's for those calendar years and divided the total (\$570,478.00) by the number of months in which the restaurant was operated in those years (34) to obtain average monthly sales of \$16,778.76. From this figure, he subtracted average monthly taxable sales reported to obtain an average monthly difference of \$1,691.73. This amount was multiplied by the number of months in the audit period (39) to calculate additional taxable sales of \$65,977.47 with a tax due on that amount of \$4,618.42.

14. The Division's position is that, in the absence of adequate books and records, it was entitled to estimate the tax using a margin of error obtained from the 1983 returns. The Division maintains that calculating petitioner's tax liability using the 1982 Federal Schedule C results in an increase in petitioner's tax liability of \$1,776.39. It arrives at this determination by attributing gross receipts reported by petitioner for 10 months of calendar year 1982 to the first 7 months of the audit period. In doing so, the Division attributes receipts earned before the period of assessment to periods within the assessment period.

CONCLUSIONS OF LAW

A. The Tax Law imposes a tax on the sale of food and drinks by restaurants and taverns (Tax Law § 1105[d][i]). The vendor of food and drinks is required to collect this tax on behalf of the state and is obligated to "keep records of every sale...and of all amounts paid, charged or due thereon" (Tax Law § 1135[a]). Where adequate records are not maintained the Division is authorized to estimate the tax due on the basis of the information available to it and, if necessary, on the basis of external indices (Tax Law § 1138[a][1]; Matter of Carmine Restaurant v. State Tax Commn., 99 AD2d 581). Considerable latitude is given to an auditor's method of estimating sales where adequate books and records are not available. The audit will stand if there is sufficient evidence to establish that "a rational basis existed for the auditor's computation" (Matter of Grecian Square v. New York State Tax Commn., 119 AD2d 948).

B. Petitioner's books and records were inadequate for audit purposes; therefore, the Division was required to estimate the tax due on the basis of the information available to it. However, there is no evidence establishing that there was a rational basis for estimating the tax entirely on the basis of Federal returns filed for calendar year 1983, while ignoring the 1982 and 1984 returns. The record shows that those returns were available at the time of audit and that the rate of difference between the amounts shown on the Federal and State returns in those years was less than the rate calculated for 1983. Accordingly, the Division is directed to recalculate petitioner's tax liability using rates of difference of 6.89 percent for the period June 1, 1982 through November 30, 1982; 35.22 percent for the period December 1, 1982 through November 30, 1983; 4.1 percent for the period December 1, 1983 through November 30, 1984; and 10.91 percent for the period December 1, 1984 through August 31, 1985.

C. Where a penalty is asserted under Tax Law § 1145(a)(1)(i), as it was here, an abatement is required if it is determined that failure to comply with the Tax Law was due to reasonable cause and not due to willful neglect (Tax Law § 1145[a][i][iii]). The regulations of the Commissioner of Taxation and Finance state that reasonable cause may include "[a]ny...cause for delinquency which would appear to a person of ordinary prudence and intelligence as reasonable cause" (20 NYCRR 536.5 [a][5]). In determining whether the taxpayer made a reasonable effort to comply with and to fulfill his obligations under the Tax Law, it is appropriate to consider the experience, knowledge and education of the taxpayer (see, e.g., Matter of Jack La Russa d/b/a Jack's Pizza, State Tax Commission, April 4, 1986; Matter of Daniel Biangasso, State Tax Commission, January 28, 1986).

While Mr. Anagnostakos was an established businessman, he was not knowledgeable in the areas of taxation and accounting. He hired an accountant to establish a recordkeeping system for him, to advise him of his obligations under the Tax Law and to prepare his tax returns. Because of his own lack of knowledge in tax matters, he relied entirely on his accountant to accurately determine and report his taxes. The degree to which reported sales were understated was not so large that it in itself should have placed petitioner on notice that his accountant's calculations were inaccurate. Furthermore, Mr. Anagnostakos obtained a new accountant when he became aware of the inadequacies of his old one. Under these circumstances, it is concluded that petitioner's failure to accurately report taxable sales and the tax due on those sales was due to reasonable cause and was not due to willful neglect.

D. The petition of George Anagnostakos is granted to the extent indicated in Conclusions of Law "B" and "C"; the notices of determination issued on December 19, 1985 shall be modified accordingly; and in all other respects, the petition is denied.

DATED: Albany, New York
August 4, 1988

Corigliano _____ /s/ Jean
ADMINISTRATIVE LAW JUDGE